83-1742

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IN THE

Supreme Court of the United States

OCTOBER TERM 1983

JAMES C. SCOTT,
JAMES SCOTT & ASSOCIATES, INC.
and COMMUNICATIONS SYSTEMS, INC.,

Petitioners

VS.

BETTY JANE SIEBEL, Executrix of the
Estate of Eldon K. Siebel, Deceased,
NORMAN HOFFMAN, RODNEY MOORE,
KENNETH C. KROGH, GEORGE E. PLUM,
VERNON SCHOEMAKER and ROBERT HODGES,

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Is a privately negotiated repurchase of 100% of the outstanding interests in a limited partnership in order to reacquire leased assets, when viewed in terms of the economic reality of the transaction, a purchase or sale of securities under the Securities Exchange Act of 1934, § 10b, 15 U.S.C. § 78j(b) and Rule 10b-5 of the Securities and Exchange Commission.

The question concerns the applicability of the "sale-of-business" doctrine which has been adopted in several Circuits and rejected in others. The doctrine has been adopted by the Seventh,[1] Tenth,[2] and Eleventh Circuits,[3] rejected by the Second,[4] Third,[5] Fourth,[6] and Fifth Circuits,[7] and is the subject of a pending petition for writ of certiorari before this Court.[8]

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[1] *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982).

[2] *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977).

[3] *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982).

[4] *Golden v. Garafalo*, 678 F.2d 1139 (2nd Cir. 1982) and *Vista Resources, Inc. v. The Seagrave Corp.*, 696 F.2d 227 (2nd Cir. 1982).

[5] *Glick v. Campagna*, 613 F.2d 31, 35 n. 3 (3rd Cir. 1979).

[6] *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979) *cert. denied* 444 U.S. 868 (1979).

[7] *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983).

[8] *Vista Resources, Inc. v. The Seagrave Corp.*, No. 83-1084.

LISTING OF PARTIES

Petitioners are:

James C. Scott ("Scott")
James Scott & Associates, Inc. ("JSA") and
Communications Systems, Inc. ("CSI") (now Scott Cable Communications, Inc.)

Respondents are:

Betty Jane Siebel, Executrix of the Estate of Eldon K. Siebel, Deceased
Norman Hoffman
Rodney Moore
Kenneth C. Crogh
George E. Plum
Vernon Schoemaker and
Robert Hodges

James Scott & Associates, Inc. has no parent company, subsidiaries or affiliates. Communications Systems, Inc. (now Scott Cable Communications, Inc.) has no parent company or affiliate and no subsidiaries other than wholly-owned subsidiaries. [Rules of the Supreme Court of the United States, Rule 28.1]

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TABLE OF AUTHORITIES

IN THE

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Petitioners

VS.

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VERNON SCHOEMAKER and ROBERT HODGES,

Respondents

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners respectfully request the issuance of a writ of certiorari to review the decision of the United States Court of Appeals for the Fifth Circuit in this case dated February 27, 1984.

OPINION BELOW

The opinion of the Court of Appeals, dated February 27, 1984, reported at 725 F.2d 2233 (5th Cir. 1984), is reproduced as Appendix A.

STATEMENT OF JURISDICTION

The Judgment of the Court of Appeals was entered on February 27, 1984. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statutory provisions involved are those sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 which define a "security." These are 15 U.S.C. § 77b(1) and 15 U.S.C. § 78c(a)(10). Both provisions are reproduced as Appendices B and C, respectively. Also involved is section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j, and Securities and Exchange Commission Rule 10b-5 promulgated thereunder. These are reproduced as Appendices D and E, respectively.

STATEMENT OF THE CASE

Respondents, seven of eleven former limited partners in a partnership formed to purchase and lease cable television assets, sued Petitioners, the general partner, its parent and the ultimate individual owner, alleging violations of Section 10 of the Securities Exchange Act of 1934 (the "Act") and Rule 10-b of the Securities and Exchange Commission (the "Rule"). The claims arose from the nonpublic repurchase by one of the Petitioners of 100% of the partnership interests in order to liquidate the partnership and reacquire its assets. Both the District Court and the Court of Appeals held that the interests were securities despite the Petitioner's contention that the transaction was, in economic reality, beyond the intended scope of the Act.

The Transaction

The partnership was formed by the Petitioners in 1974 when eleven limited partners each contributed $5,500 which the partnership used, along with two bank loans, to purchase cable television equipment from one of the Petitioners.* The partnership then leased the equipment back to Petitioner

*Respondents are seven of the eleven limited partners.

Communicationas Systems, Inc. ("CSI") which operated the cable television system for its own account. The lease provided for fixed monthly rentals for ten years, after which CSI had the option to purchase the assets for a fraction of market value. CSI paid all expenses of operating the system and the equipment, and the partnership had no financial obligations other than the two purchase money notes which were being repaid from rents. The partnership thus had no business operations and was merely a vehicle for the Respondents to gain tax advantages from the purchase and leaseback of assets while receiving a fixed rate of return on their investment.

Four years later, in 1978, the equipment became technologically obsolete and the system encountered unexpected competition which jeopardized its municipal franchise. Petitioner James C. Scott ("Scott") had discussions with several Respondents and asked them to invest additional money to upgrade the assets, told them that they could otherwise simply hold CSI to the lease, and then offered to have Petitioner Jim Scott and Associates ("JSA") purchase their interests. Ultimately all of the partners declined the first two proposals and sold their interests to JSA for $5,274 each and the assumption of the partnership's two existing notes. The sale could have been accomplished without any transfer of partnership interests by JSA simply purchasing the assets from the partnership and distributing the sales proceeds to the partners upon dissolution. JSA dissolved the partnership, renovated and enhanced the equipment, and then resold it to another tax-driven partnership which CSI operates under a management agreement.

The Proceedings Below

The District Court concluded, after trial, that the partnership interests were securities within the scope of the Act

and Rule and proceeded to adjudicate the Respondents' claims on that premise.

The Court of Appeals first confirmed its earlier rejection of the sale-of-business doctrine in *Daily v. Morgan*,[10] but then held that the doctrine had no bearing upon this case because the interests were investment contracts, not corporate stock. In an unprecedented analysis, it concluded that the interests were securities in the hands of the sellers but not securities to the purchaser. Thus the Court held that the transaction was a sale, but not a purchase, of securities, stating:

> Otherwise stated, transactions involving the sale of an interest in a venture which is a security because it is an investment contract can be Janus-faced — simultaneously looking toward and away from status as a security.

REASONS FOR GRANTING THE WRIT

This petition should be granted so that this Court may resolve the conflict among the Circuits as to the applicability of the sale-of-business doctrine. The conflict is complete and widespread. The doctrine has been adopted in the Seventh, Tenth and Eleventh Circuits and rejected in the Second, Third, Fourth and Fifth Circuits.[11] Both points of view are, according to the respective Circuits, firmly grounded in policy and Congressional intent, yet the decisions are diametrically opposed.

The progenitor of the sale-of-business doctrine is the reasoning in *SEC v. Howey Co.*[12] and *United Housing Foun-*

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[10] 701 F.2d 496 (5th Cir. 1983).

[11] See notes 1-7, *supra*.

[12] 328 U.S. 293, 66 S.Ct. 1100 (1946).

dation, Inc. v. Foreman.[13] In each case, this Court held that substance, not form, determines whether or not a particular transaction involves a security subject to the protection of the Act.[14] The Howey-Forman definition of a security is an investment of money in a common enterprise in which the investor, having no control over the investment or enterprise, expects profits from the efforts of others.

The Court of Appeals in this case ostensibly analyzed the limited partnership interests in light of such reasoning, but gave no consideration to the form of the transaction itself.[15] That analysis is suspect since the Court found an investment contract although the Respondents received only a fixed rate of return from the leased assets and did so whether the managerial efforts of the Petitioners were successful or not.[16] But, despite the intrinsic nature of the ownership interest, it is either a security or not — it cannot be both and neither at the same time.

The final determination should turn upon the Act's Congressional objectives. Originally, the federal securities laws were intended to eliminate serious abuses in what was, at the

[13]421 U.S. 837, 95 S.Ct. 2051 (1975).

[14]Also see, *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 99 S.Ct. 244 (1979) and *Marine Bank v. Weaver*, 455 U.S. 551, 102 S.Ct. 1220 (1982).

[15]The holding that a limited partnership interest is a security to only one of two parties to a purchase transaction is apparently supported only by the reasoning of one commentator, *Seldin*, When Stock is Not a Security: The "Sale of Business" Doctrine Under the Federal Securities Laws, 37 Bus.Law. 637 (1982). The effect of the decision is that sellers are protected by the Act but purchasers are not, an anomalous result in light of the issuer reporting requirements, insider trading restrictions and broker-dealer regulations in the Act, all of which apply to both purchasers and sellers of securities.

[16]The purchase option was six years from fruition and, since the assets were almost worthless, was not likely to be exercised.

time, a largely unregulated securities market.[17] The focus of the Act is on the capital market of the enterprise system, (*i.e.* the sale of securities to raise capital for profit-making purposes), the exchanges upon which securities are traded, and the need for regulation to prevent fraud and to protect the interests of investors. Petitioners respectfully suggest that privately negotiated sales of businesses are not the types of transactions to which the Act was intended to apply.

In modern times, a purchaser who buys an incorporated or partnership business usually has the choice of purchasing ownership interests or purchasing assets and assuming liabilities. Frequently it is advantageous to purchase ownership interests in order to acquire a going business, tax advantages, rights to do business in various states, corporate franchises, leases without landlord consent or various other commercial values. On the other hand, a purchaser may elect to buy assets and assume liabilities in order to avoid undisclosed liabilities or merely simplify the transaction. Either way, he is combining his managerial or entrepreneurial efforts with his own money, and his choice of form is usually one of convenience. If he elects to purchase assets and assume liabilities, then he is free from the constraints of the Act throughout the United States. If, however, he chooses to purchase ownership interests, then in many states he will be subject to the Act, and in others he will not. It is inconceivable that the drafters of the Act intended to regulate the sale of an incorporated corner drug store under the same statutory scheme that it used to protect investors in national securities markets, yet that is the effect of the Court of Appeals' decision in this case, and it should be reviewed and then reversed by this Court.

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[17] *United Housing Foundation, Inc. v. Forman, supra* note 13.

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Dated this 16th day of April, 1984.

Respectfully submitted,

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By: Tom Thomas
Tom Thomas
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CERTIFICATE OF SERVICE

I hereby certify that three true and correct copies of the foregoing instrument were forwarded in the United States mail, postage prepaid, to Mr. Carl A. Generes, 919 Glen Lakes Tower, 9400 North Central Expressway, Dallas, Texas 75231 and Mr. Richard C. Guinan, Jr. and Mr. John O. Cunningham, Denton & Davis, 555 Griffin Square Building, Suite 920, Dallas, Texas 75202 this 16th day of April, 1984.

Tom Thomas
Tom Thomas

APPENDIX

Appendix A

Opinion of the United States Court of Appeals for the Fifth Circuit

Betty Jane SIEBEL, Executrix of the Estate of Eldon K. Siebel, Deceased, et al., Plaintiffs-Appellants Cross-Appellees,

v.

James C. SCOTT, et al., Defendants-Appellees Cross-Appellants.

No. 82-1713.

United States Court of Appeals, Fifth Circuit.

Feb. 27, 1984.

Seven of 11 former limited partners in limited partnership formed to own and operate cable television system brought action against general partner, its parent corporation, and individual who controlled both corporations alleging violation of section of Securities and Exchange Act prohibiting the use of deceptive or manipulative devices in the sale or purchase of securities. The United States District Court for the Northern District of Texas, Robert W. Porter, J., found defendants liable and awarded damages, and both parties appealed. The Court of Appeals, Patrick E. Higginbotham, Circuit Judge, held that: (1) limited partners' interest in partnership were "securities"; (2) transaction whereby interests were sold to general partner was sale of securities within meaning of securities law; (3) elements for cause of action of misrepresentation, scienter, reliance and diligence were established, and (4) limited partners in first partnership were entitled to recover greater of value of their interest at moment of sale or profit realized by general partner through resale to extent those profits were not attributable to entrepreneurial efforts.

Affirmed in part, vacated and remanded in part.

1. Securities Regulation — 42

Where limited partners in partnership formed to own and operate cable television system did not plan or desire to participate in operation of cable television system, but rather, viewed themselves as investors, paid their money and relied on managerial skills of general partner to bring profit through both lease payments and ultimate sale of assets after lease agreement, partnership interest in hands of limited partners were "securities" within meaning of section of Securities Exchange Act prohibiting the use of manipulative or deceptive devices in the sale or exchange of securities. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

2. Securities Regulation — 12, 42

For interest to be characterized as security for securities laws purposes it is not necessary that interest be deemed security in hands of both seller and purchaser.

3. Securities Regulation — 42

Where limited partners in limited partnership formed to own and operate cable television system were relying, right through to moment of sale of their interest, on entrepreneurial efforts of individual who controlled general partner for any profit from their investment in cable television system, transaction whereby limited partners sold their interests to general partner was "sale of securities" within meaning of Securities Exchange Act; therefore, limited partners were entitled to maintain suit alleging fraud in connection with the sale or purchase of securities. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

See publication Words and Phrases for other judicial constructions and definitions.

4. Securities Regulation — 117, 119

Claim under section of Securities Exchange Act prohibiting the use of deceptive or manipulative devices in the sale

or purchase of securities requires material misrepresentation, scienter, reliance, diligence, and injury. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

5. Securities Regulation — 60

District court's findings that individual in control of general partner deliberately misrepresented options available to limited partners, misrepresented his planned use of cable television assets should limited partnership terminate, falsely represented to several limited partners that each was last one deciding to sell out, and that limited partners relied on misrepresentations were sufficient to establish elements of cause of action under section of Securities Exchange Act prohibiting the use of manipulative or deceptive devices in the sale or exchange of securities that there be misrepresentation, scienter, and reliance. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

6. Securities Regulation — 139

Where limited partners put their faith in individual who controlled general partner to represent their best interest and to deal with them fairly and truthfully, and nothing individual told limited partners in procuring sales of their limited partnership interests was so inherently implausible that they were under duty to investigate further, district court's finding that limited partners exercised all due diligence required by them under section of Securities Exchange Act governing the use of deceptive or manipulative devices in the sale or exchange of securities was not clearly erroneous. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

7. Securities Regulation — 154

Where all elements of violation of section of the Securities Exchange Act prohibiting the use of deceptive or manipulative devices in the sale or exchange of securities are proven, proper measure of damages to reflect loss proximately caused by defendant's deceit is out-of-pocket rule; that rule allows

as damages difference between price received and value of securities at time of fraudulent transaction, however, evaluation of security at time of conveyance may include later developments in its price. Securities Exchange Act of 1934, § 10(b), 15 U.S.C.A. § 78j(b).

8. Securities Regulation — 154

Where sale by general partner of interests in second limited partnership followed almost immediately general partner's purchase of interests in first limited partnership, and general partner's purchase of interests in first limited partnership involved deception, investor limited partners in first partnership were entitled to recover greater of value of their interest at moment of sale or profit realized by general profit through resale to extent those profits were not attributable to enterpreneurial effort.

Appeals from the United States District Court for the Northern District of Texas.

Before GEE, TATE and PATRICK E. HIGGINBOTHAM, Circuit Judges.

PATRICK E. HIGGINBOTHAM, Circuit Judge:

In this securities case we review findings that sales of securities were procured by fraud and we explicate the proper measure of damages for such cases. We hold that interests in a limited partnership here constitute "securities," and that the plaintiffs' recovery on the facts here should be tied to the actual value of the partnership interests at the time of sale which can encompass the profit realized by the fraudulent purchaser upon subsequent resale of the underlying assets. We affirm the district court's findings of fraud, but remand for application of the proper measure of any injury.

I

Plaintiffs[1] are seven of eleven former limited partners in Cable TV of Lebanon, Ltd., a limited partnership formed to own and operate a cable television system in Lebanon, Missouri. Communication Systems, Inc., a wholly owned subsidiary of Jim Scott and Associates was its general partner. Both corporations were controlled by James C. Scott. The limited partners charge that CSI, JSA and Jim Scott fraudulently induced them to sell their partnership interests in Cable TV of Lebanon to JSA, which placed the cable TV assets into a new limited partnership, and sold its shares at a large profit. The selling partners seek disgorgement of this profit.

Cable TV of Lebanon was formed in 1974. Eleven limited partners each contributed $5,500 which the partnership used along with two bank loans to purchase the cable television equipment. The partnership then leased this equipment to CSI which took responsibility for operating the cable television system. The lease provided for a fixed monthly rental over a ten year term after which CSI would have an option to purchase the assets of the partnership at 30% or 18% of market value, for CSI stock or cash, respectively. During the lease term, CSI was obliged to absorb all of the expenses of operating the television system.

In the spring of 1978, Jim Scott called a meeting of the partnership to discuss changing competitive conditions that were threatening the profit of its cable system. Three limited partners attended the meeting which was held on May 4, 1978. They learned from Scott that due to the move of a broadcast facility in Springfield, Missouri, residents of Lebanon were now able to receive programming from the three commercial networks as well as public television, greatly decreasing the need for cable television services. Scott explained that the cable television system needed general upgrading and expansion, and to remain

[1]We summarize the facts supportive of the district court findings and do not summarize conflicting evidence unless necessary to context.

competitive it would need to install an earth receiving station which could provide a broad variety of television programming.

Scott told the limited partners that the improvements he envisioned would require substantial new capital. Scott also explained that these new capital improvements would not provide the tax benefits their original investments had won for them. Scott informed the limited partners that they had a choice either to invest more funds in the cable system or to sell their interests in that system back to JSA. Scott insists that he also informed the partners that they had the option of doing nothing and holding CSI to the terms of its ten year lease with the partnership. This testimony was controverted and the district court found that Scott did not in fact inform the partners of this option. Indeed the record supports a reasonable inference that Scott tried to persuade the limited partners that their investment had soured and that they were fortunate for an opportunity to sell out to JSA. He also omitted to tell the limited partners of his plans for the cable system following their sale to him. Each partner was offered $5,274 for his partnership interests. Though this sum was only slightly less than the $5,500 that each partner had originally invested, most of this money ultimately was paid in federal income taxes for recaptured accelerated depreciation deductions taken by the partners on the cable system's assets.

Following the meeting with the three limited partners, Scott contacted all but one of the remaining partners and gave them a briefer version of the presentation he had made at the meeting. Each was told of the cable system's financial troubles, and each was encouraged to sell his interest in the partnership to JSA. None were told that they could hold CSI to its obligations under the lease with the partnership. The record permits the inference that several of the partners were led to believe that each was the sole remaining partner who had not yet agreed to sell his partnership interests to JSA.

When all partners had sold, JSA terminated the Cable TV of Lebanon partnership. JSA then transferred the cable television assets into a new partnership also named Cable Television of Lebanon, Ltd. A group of investors paid a total of $595,000 in cash for shares in this second limited partnership. The partnership then gave JSA a note for $1,350,000 in payment for the cable television assets. Of this sum, $800,000 was guaranteed by the limited partners. Once again CSI served as general partner.

This suit followed. In sum, the limited partners from the first partnership sued Scott, JSA, and CSI, claiming that as a result of Scott's fraudulent conduct these defendants were able to reap a windfall by purchasing the cable television system from the first partnership for an aggregate of approximately $232,000 in cash and assumed loans, thereafter selling the same assets to the second partnership for $1,350,000. The plaintiffs sought disgorgement of this alleged windfall profit. After a bench trial the district court held that Scott had engaged in misrepresentation and fraudulent conduct and had thereby impelled the limited partners to sell their partnership interests to JSA. In particular, the court found that Scott had not informed the limited partners that if they did not want to sell out they were free to hold CSI to the terms of its ten year lease with the partnership. In accordance with this finding, the district court held that the damages suffered by the partners was the loss of the rental payments they would have received had the lease continued to the end of its term. The limited partners were awarded slightly over $60,000 in actual damages, the aggregate sum payable over the remaining term of the lease, with $50,000 in punitive damages and $50,000 in attorney's fees.

The limited partners appeal from the damage verdict. Agreeing with the finding of misrepresentation and resultant liability, they insist that defendants should have been ordered to disgorge the "entire" profit of slightly over $1,000,000. Defendants also appeal, challenging the finding of liability and insisting that investors were dealt with fairly, had no material facts misrepresented to them, and received a fair price for their partnership interests.

II

[1] The selling limited partners stated claims under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, presenting the threshold question of whether the limited partnership interests were "securities." We hold that these interests were securities in the hands of the sellers, and that a § 10b action was maintainable for fraud in connection with their sale.

The concept of "security" found in the securities laws "is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits." *S. E. C. v. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244 (1946). An "investment contract" may take many forms dissimilar to traditional stocks, bonds, or debentures. "The test is whether the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others." *Id.* at 301, 66 S.Ct. at 1104; *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851-53, 95 S.Ct. 2051, 2060, 44 L.Ed.2d 621 (1975).

In their hands, the interests of the limited partners pass this test. There is no evidence that any of the limited partners planned or desired to participate in the operation of the cable television system. The limited partners viewed themselves as investors the securities laws were designed to protect: they paid their money and relied on the managerial skills of the general partner to bring profit through both the lease payments and the ultimate sale of the assets after the lease term. A sale and leaseback arrangement essentially identical to this one was recently held by the Ninth Circuit to constitute a security in the hands of the limited partners, *United States v. Jones*, 712 F.2d 1316, 1321-22 (9th Cir.), *cert denied*, —— U.S. ——, 104 S.Ct. 434, 78 L.Ed.2d 366 (1983).

But, Scott counters, the present transaction was not a purchase or sale of securities because the net effect of the sale to JSA of all the limited partnership interests was to

transfer to the purchaser the assets of the cable television system rather than any interest that could be characterized as a security. The limited partners reply that this circuit does not accept the "sale of business" doctrine.

The reply misapprehends the application of the doctrine. In *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983), we held that ordinary corporate stock does not lose its character as a security, even when its owner is also the entrepreneur controlling the venture and therefore is not relying on the managerial skills of another for his profit. Thus, a sale of all the stock of a corporation is a purchase and sale of securities despite the economic reality that the sale transfers business assets from one entrepreneur to another with neither the purchaser nor the seller dependent upon the managerial skill of another. *Accord, Golden v. Garafalo*, 678 F.2d 1139 (2d Cir. 1982); *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir.), *cert. denied*, 444 U.S. 868, 100 S.Ct. 142, 62 L.Ed. 2d 92 (1979).

Some circuits have endorsed the "sale of business" rule, holding that even ordinary stock loses its character as a security if it reifies the interest of an entrepreneur rather than an investor, *Kink v. Winkler*, 673 F.2d 342 (11th Cir. 1982); *Frederiksen v. Poloway*, 637 F.2d 1147 (7th Cir.), *cert. denied*, 451 U.S. 1017, 101 S.Ct. 3006, 69 L.Ed.2d 389 (1981); *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977). These courts perform a *Howey-Forman* analysis regardless of the form taken by the putative security, whereas courts rejecting the "sale of business" rule will not perform that analysis when the security takes a "traditional" form such as ordinary corporate stock. All courts agree, however, that a *Howey-Forman* analysis is required when the interest takes the form of an "investment contract" or an "instrument commonly known as a 'security' "; that was, after all, the precise holding of these Supreme Court cases. It is plain, then, that our rejection of the "sale of business" rule for corporate stock is of no assistance to the investors here, whose interests, if they are securities at all, are best described as investment contracts.

[2] We agree perforce that the partnership interests were not securities in JSA's hands; JSA certainly was not relying on another's managerial skills for its profit. However, it is not necessary that an interest be deemed a security in the hands of both the seller and the purchaser.

[3] The characterization of an interest as a security or not can vary with the relationship of its holder to the venture. If the interest takes the form of an investment contract, *Howey* teaches that it is a security only if the holder is relying on the managerial skills of others to generate his profit. By implication, if the holder is relying on his own entrepreneurial talents to generate his profit, his interest is not treated as a security because he does not fall within the class of persons Congress meant to protect when it included non-traditional securities in the coverage of the securities laws. *Cf. Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982) (drawing a line of demarcation between "investors" and "entrepreneurs," and applying this distinction in a case involving sales of ordinary stock, in keeping with the Seventh Circuit's adherence to the sale of business rule). Here, the limited partners were relying, right through to the moment of sale, on Scott's entrepreneurial efforts for any profit from their investments in the cable television system. The partnership interests changed character only at the moment of sale, and we deem the transaction a sale of securities though not a purchase of securities. Consequently, the sellers are entitled to maintain this suit under the Securities Exchange Act. Otherwise stated, transactions involving the sale of an interest in a venture which is a security because it is an investment contract can be Janus-faced — simultaneously looking toward and away from status as a security.

III

[4, 5] A claim under § 10(b) requires material misrepresentation, scienter, reliance, diligence, and injury. *See Dupuy v. Dupuy*, 551 F.2d 1005, 1014 (5th Cir.), *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977). The findings that Scott deliberately misrepresented the options available to the limited partners, misrepresented his planned use of

the cable television assets should the partnership terminate, and falsely represented to several limited partners that each was the last one deciding to sell out to JSA are not clearly erroneous,[2] and supply the first two elements of a § 10(b) violation.[3]

Similarly, the district court's finding of reliance by the limited partners on these misrepresentations is not clearly erroneous.[4] Though the partners articulated differently their

[2]Scott claims that the district court's findings must be clearly erroneous with respect to one plaintiff who testified that Scott informed the limited partners at the meeting that they had the option of holding CSI to its lease. Scott's argument is that this testimony was an admission and that the trial court cannot make a finding with respect to that party which contradicts that admission. We disagree. The parties entered into no stipulation concerning the discussions at this meeting, and the district court was charged, in the face of conflicting testimony, with making a single finding as to the statements there made by Scott. There was no evidence that Scott made any statements to any of the individual partners not made to the entire group. Accordingly, the trial judge had to determine which of the partners was mistaken in recalling whether or not Scott had told them that they could hold CSI to its lease, and we sustain his implicit finding that the mistaken partner was the one who thought he recollected hearing this statement made.

[3]We qualify this holding with respect to plaintiff Dr. Rodney Moore. Moore testified, congruently to Scott's testimony, that Scott never contacted Moore as he contacted the other partners to discuss the problems facing the cable system. The first Moore knew of this affair was when one of Scott's employees delivered a check to him for his partnership interest and told him, truthfully, that all the other limited partners were selling their shares. Thus if liability here turns on any affirmative misrepresentation made to the partners, Moore cannot recover because he never heard any misstatements, either directly from Scott or indirectly from his fellow partners. If, however, liability turns on Scott's omission of material facts, Moore is also entitled to recover for any injury. *See* note 4, *infra*. This determination is for the district court on remand.

[4]Where, as here, an investor is induced to sell his securities as a result of the buyer's omission of material facts, the required showing of reliance takes a different stance. The Supreme Court noted in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54, 92 S.Ct. 1456, 1472, 31 L.Ed.2d 741 (1972), that in a case such as this, "positive proof of reliance is not a prerequisite to recovery. All that is necessary is that the facts withheld be material in the sense that a reasonable investor might have considered them important in the making of this decision."

individual reasons for selling their interests in Cable Television of Lebanon, we cannot find clearly erroneous the findings that Scott's efforts to induce a sale were material. When a deceiving purchaser casts his net broadly and hauls in every fish, the reliance element in § 10(b) is inferable if it appears that no plaintiff planned to sell his security before the defendant undertook fraudulently to induce the sales.

[6] While the question is a close one, we are also satisfied that the district court did not err in concluding that the limited partners exercised all the diligence required of them by the Securities Exchange Act. In *Dupuy*, 551 F.2d at 1016-20, we explained at length that only a gross departure by an investor from the standard of due care will deny him recovery under § 10(b). The investors here put their faith in Scott to represent their best interests and to deal with them fairly and truthfully. The requirement that a plaintiff exercise due diligence is not applied stringently. While incentives born of self interest ought not be discouraged, a more exacting application will only reward the wily defendant who discourages such a questioning attitude. Nothing that Scott told the limited partners in procuring these sales was so inherently implausible that they were under a duty to investigate further.[5]

IV

The main fight here is over injury. The limited partners charge that Scott induced them to sell their interests at an artificially low price, and promptly repackaged and resold the cable system to a second partnership, reaping a windfall profit in the process. Scott responds that the partners were

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[5] Scott points out that the limited partners could have discovered simply by reading their prospectuses that they had the ability to hold CSI to its lease. We could go further and say that the partners are chargeable with knowledge of this fact. Nevertheless, it is of no help to Scott because one limited partner testified that Scott had threatened to have CSI breach its obligations under the lease, and Scott himself testified that CSI had no money during this period. Though Scott's testimony on the latter point need not be credited, we will not entertain an argument by him that rests on a contrary supposition.

paid a fair price for their interests and that any profit in the resale was attributable solely to his entrepreneurial efforts.

[7] Where all the elements of a § 10(b) violation are proven, "[t]he proper measure of damages to reflect the loss proximately caused by the defendant's deceit is the out-of-pocket rule. That rule is the traditional measure of damages in a Rule 10b-5 action. . . ." *Huddleston v. Herman & MacLean*, 640 F.2d 534, 555 (5th Cir. 1981), *aff'd in part and rev'd in part*, —— U.S. ——, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983). The out-of-pocket rule allows as damages "the difference between the price received and the value of the securities at the time of the fraudulent transaction." *Alley v. Miramon*, 614 F.2d 1372, 1387 (5th Cir. 1980).

Though it appears straightforward, the out-of-pocket rule of *Alley* is not self-defining. Valuation of a security at the time of a conveyance may include later developments in its price. *Dupuy v. Dupuy*, 551 F.2d 1005 (5th Cir.1977), *citing with approval Myzel v. Fields*, 386 F.2d 718 (8th Cir.1967), *cert. denied*, 390 U.S. 951, 88 S.Ct. 1043, 19 L.Ed.2d 1143 (1968), and *Janigan v. Taylor*, 344 F.2d 781 (1st Cir.), *cert. denied*, 382 U.S. 879, 86 S.Ct. 163, 15 L.Ed.2d 120 (1965). Specifically, a defendant's profits may be disgorged where he fraudulently induces the plaintiff to sell securities to him and resells them shortly thereafter at a higher price; this despite a price "fair" by the market on the day of sale. Though it is not necessary that the fraudulent purchaser know of conditions that will shortly boost the price of the security, in this case such disgorgement only acknowledges that a fraud may encompass a skewing of the market-set price by the withholding of important pricing data, such as the willing purchaser in the wings. As recently explained by a sister court: "The early cases generally awarded the difference between the value given and the value received, but the recent trend looks to defendant's profits, rather than to plaintiff's losses, in measuring damages." *Nelson v. Serwold*, 576 F.2d 1332, 1338 (9th Cir.), *cert. denied*, 439 U.S. 970, 99 S.Ct. 464, 58 L.Ed.2d 431 (1978) (citing *Janigan* and *Myzel*).

Janigan v. Taylor pioneered the disgorgement remedy for defrauded sellers of securities. The court there recognized that a profit made by the defendant would not necessarily have accrued to the plaintiff had there been no fraudulently-induced sale.

> However, there can be no speculation but that the defendant actually made the profit and, once it is found that he acquired the property by fraud, that the profit was the proximate consequence of the fraud. . . . It is more appropriate to give the defrauded party the benefit even of windfalls than to let the fraudulent party keep them.

344 F.2d at 786. This rule has been adopted by the Supreme Court in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1971). The Court there held:

> In our view, the correct measure of damages . . . is the difference between the fair value of all that the . . . seller received and the fair value of what he would have received had there been no fraudulent conduct, *except for the situation where the defendant received more than the seller's actual loss. In the latter case damages are the amount of the defendant's profit.*

Id. at 155, 92 S.Ct. at 1473 (emphasis added; citations omitted). We have recognized the force of this holding in *Huddleston*, *Alley*, and *Dupuy*.

A significant limitation on the disgorgement doctrine is that a plaintiff may not recover any portion of the profits attributable to the defendant's "special or unique efforts . . . other than those for which he is duly compensated." *Nelson v. Serwold*, 576 F.2d at 1338 n. 3. Though the defendant might not have had an opportunity to generate these profits absent his fraud, nevertheless they cannot be deemed a windfall in the manner of profits not attributable to the defendant's entrepreneurship.

[8] Here, the sale by JSA of interests in the second limited partnership followed almost immediately JSA's purchase of the interests in the first limited partnership.

Consequently, the investors in the first partnership are entitled to recover the greater of the value of their interests at the moment of sale or the profit realized by JSA through the resale to the extent these profits are not attributable to Scott's entrepreneurial efforts.

Given its choice of a measure of damages, the district court understandably made no explicit finding as to either of these values, and the court's damage award — the rental payments that would have been owing over the remaining term of the lease — does not manifestly represent either one.[6] We are driven then to a remand for further findings respecting the value of the securities at the time of sale and the profit realized by JSA by the resale.

On remand the district court should assess the value of the interests held by the limited partners, recollecting that market value of the cable television assets may be a relevant consideration but does not alone control this inquiry. Under the terms of the lease the partners had a right to future rentals regardless of whether the cable operation was profitable; however, the value of the assets would determine how much the partners would have received at the end of the lease term when CSI exercised its option to purchase the assets for 30% of their value in CSI stock of 18% of their value in cash. To calculate the value of the partners' rights under the option, the district court must make a reasonable estimate of the value the assets would have had in 1984 had there been no infusion of new capital that accompanied the formation of the second limited partnership.

The district court must also determine whether Scott reaped any windfall profit when he placed the cable television assets into a second limited partnership, shares of which were then sold to a second group of investors. This inquiry may be complicated by the fact that the venture was tax-driven, and the $1,350,000 pricetag attached to the assets could have no relation to the investment actually made by the new partners; even the $800,000 portion of this note that was guaranteed by the investors may be a chimera if it is

[6]The district court also allowed the plaintiffs to retain the payments made to them by JSA for their interests, lending further uncertainty to the meaning of the damage award.

offset by inflated distributions to partners or rental payments under a new lease. Additionally, any portion of the price paid by the second partnership for the assets that is attributable to improvements made by Scott to the cable system, other than the routine maintenance that he was already obliged to provide under his agreement with the first partnership, may not be included in the calculation of Scott's windfall profit. By necessity if any profit on resale is attributed solely to Scott's efforts there will be no disgorgement of that profit.

Because the district court traveled a different path in calculating damages, its findings do not enable us to determine whether the price paid to the limited partners for their interests in Cable TV of Lebanon, Ltd. was an unfair price or whether Scott realized any windfall profit by selling the cable system assets to a second partnership. Accordingly, we vacate the district courts finding of injury and the damage award which followed therefrom. The award of punitive damages[7] and attorneys' fees is necessarily vacated as well. On remand, only the question of injury will be before the district court, for that able court has already found misrepresentation, scienter, reliance, and diligence, and those findings are all affirmed.

Some of these findings are sufficiently tied to the question of injury that our affirmance is to some degree contingent. If Scott paid the limited partners a fair price for their interests, it follows that he cannot have misrepresented the value of those interests, with or without scienter. In any event, the record would permit a trier of fact to infer that, in his eagerness to terminate the first partnership, Scott misrepresented the options available to the partners and which of the partners was actually the last to agree to the sale. Our affirmance of these findings should not be taken to intimate any predisposition on the question of injury or to so set the law of the case that the district court cannot look again at a finding of liability should its new damage inquiry implicate its earlier liability findings.

AFFIRMED in part; VACATED and REMANDED in part.

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[7]Though punitive damages are not awardable under § 10(b), they are available under the Texas Securities Act, which was also pleaded by the plaintiffs.

Appendix B

15 U.S.C. 77b(1)

Definitions

When used in this subchapter, unless the context otherwise requires —

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security", or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

Appendix C

15 U.S.C. 78c(a)(10)

(10) The term "security" means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit-sharing agreement or in any oil, gas, or other mineral royalty or lease, any collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit, for a security, or in general, any instrument commonly known as a "security"; or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing; but shall not include currency or any note, draft, bill of exchange, or banker's acceptance which has a maturity at the time of issuance of not exceeding nine months, exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.

Appendix D

15 U.S.C. § 78j

Manipulative and deceptive devices

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

(a) To effect a short sale, or to use or employ any stop-loss order in connection with the purchase or sale, of any security registered on a national securities exchange, in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Appendix E

Securities and Exchange Commission Rule 10b-5

17 C.F.R. § 240.10b-5 (1983)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,

(a) to employ any device, scheme, or artifice to defraud,

(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

NO. 83-1742

IN THE

Supreme Court of the United States

OCTOBER TERM 1983

JAMES C. SCOTT,
JAMES SCOTT & ASSOCIATES, INC.
and COMMUNICATIONS SYSTEMS, INC.,

Petitioners

VS.

BETTY JANE SIEBEL, Executrix of the
Estate of Eldon K. Siebel, Deceased,
NORMAN HOFFMAN, RODNEY MOORE,
KENNETH C. KROGH, GEORGE E. PLUM,
VERNON SCHOEMAKER and ROBERT HODGES,

Respondents

SUPPLEMENT TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Respectfully submitted,
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Respondents

SUPPLEMENT TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners respectfully supplement their petition for a writ of certiorari which was docketed April 16, 1984 as follows:

REASONS FOR GRANTING THE WRIT

Since the petition was filed, certain cases have been reported regarding the sale-of-business doctrine, one in the

Ninth Circuit[1] and one in a Texas appellate court.[2] The *Landreth* decision is substantially the same as decisions in the Seventh, Tenth and Eleventh Circuits adopting the doctrine. The *Star Supply Company* case applies *Howey-Forman* reasoning but simultaneously ignores the Fifth Circuit's rejection of the doctrine. Thus in Texas, the state courts apply this Court's approach of substance over form, but the federal courts do not, an anomalous result.

Dated this 11th day of May, 1984.

Respectfully submitted,

KOLODEY THOMAS
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Dallas, Texas 75219
(214) 528-5511

By: Tom Thomas
Tom Thomas
Attorneys for Petitioners

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[1]*Landreth Timber Co. v. Landreth*, [Current Developments] Fed. Sec. L. Rep. (CCH) ¶ 99,705 (9th Cir., March 7, 1984).

[2]*Star Supply Company, et al v. Robert D. Jones, et al*, 665 S.W.2d 194 (Tex. Civ. App. — San Antonio 1984).

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing instrument was forwarded in the United States mail, postage prepaid, to Mr. Carl A. Generes, 919 Glen Lakes Tower, 9400 North Central Expressway, Dallas, Texas 75231 and Mr. Richard C. Guinan, Jr. and Mr. John O. Cunningham, Denton & Davis, 555 Griffin Square Building, Suite 920, Dallas, Texas 75202 this 11th day of May, 1984.

Tom Thomas

Tom Thomas

83 - 1742

NO. 83-1742

In The

Supreme Court of the United States

October Term, 1983

James C. Scott,
James Scott & Associates, Inc.
and Communications Systems, Inc.,

Petitioners,

vs.

Betty Jane Siebel, Executrix of the
Estate of Eldon K. Siebel, Deceased,
Norman Hoffman, Rodney Moore,
Kenneth C. Krogh, George E. Plum,
Vernon Schoemaker and Robert Hodges,

Respondents.

On Petition for a Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Attorney for Respondents

May, 1984

QUESTION PRESENTED

Are sales by limited partner investors of 100% of their interests in a limited partnership to the general partner (in reliance on the willful, intentional and malicious fraudulent representations of the general partner) sales of securities under the Securities Exchange Act of 1934, §10b, 15 U.S.C., §78j(b) and Rule 10b-5 of the Securities and Exchange Commission?

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IN THE

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OCTOBER TERM, 1983

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vs.

BETTY JANE SIEBEL, Executrix of the
Estate of Eldon K. Siebel, Deceased,
NORMAN HOFFMAN, RODNEY MOORE,
KENNETH C. KROGH, GEORGE E. PLUM,
VERNON SCHOEMAKER and ROBERT HODGES,

Respondents.

On Petition for a Writ of Certiorari To The United States Court of Appeals for the Fifth Circuit

BRIEF OF RESPONDENTS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

TO THE HONORABLE SUPREME COURT OF THE UNITED STATES:

The Respondents respectfully submit this Brief in Opposition to the Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit.

STATEMENT OF THE CASE

Parties

James C. Scott, an individual, ("Scott") and the corporations, Communications Systems, Inc. ("CSI") and Jim Scott & Associates, Inc. ("JSA"), both wholly owned by Scott, are the Petitioners herein. The Respondents are seven former limited partner-investors (the "Investors") in a limited partnership (the "Partnership") the general partner of which was CSI.

The Transactions

The limited partnership interests were sold to the Investors in 1974 through a private placement memorandum prepared by Petitioners which stated that the limited partnership interests being offered had not been registered under the Securities Act of 1933 by reason of specific exemptions therefrom. With the proceeds of bank loans and limited partner capital contributions, the Partnership acquired, in 1974, a cable television system located in Lebanon, Missouri which it leased to CSI for ten years. The lease agreement provided for a fixed monthly rental payable to the Partnership and included an option to CSI to purchase from the Partnership the cable television system at the expiration of the lease at a price equal to a significant percentage of its then market value. The Investors were passive participants[1] in the venture who relied on the integrity and honesty of their general partner, CSI, and its principal, Scott, to their substantial detriment.

In May 1978, through fraudulent representations and omissions (as found by the District Court and affirmed by the Court of Appeals), the Petitioners persuaded the Investors (Respondents herein) to sell to JSA their limited partnership interests in the Partnership, which was then dissolved. Without

[1] The Investors (Respondents herein) were individual Dallas area residents, four of whom were practicing physicians, one owned and operated a car dealership, one owned and operated an airplane dealership and one owned and operated a management consulting firm.

the knowledge and in deliberate deception of the Investors, the Petitioners formed a new limit.d partnership (with the same name as the Partnership), raised $595,000 in capital contributions from twenty-five new limited partner investors and sold the cable television system to the new limited partnership. The fraudulent buyout by Petitioners of the Investors' interest in the Partnership, its dissolution, the formation of the new limited partnership and its acquisition of the cable television system were consummated within a twenty-four hour period on July 31, 1978 and August 1, 1978. Despite Petitioner's contentions to the contrary, there is no evidence or finding by the District Court that JSA renovated or enhanced the cable television system between the date of its acquisition upon dissolution of the Partnership on July 31, 1978 and sale to the new limited partnership on August 1, 1978 or at anytime prior thereto.

REASONS FOR DENYING THE WRIT

While this Court may need to resolve a conflict among the Circuits concerning the sale-of-business doctrine as it applies to a security which takes a "traditional" form such as ordinary corporate stock, the limited partnership interests of the Respondents were not of such "traditional" form. As the Court of Appeals found, they were "investment contracts." This Court, in *S.E.C. v. Howey Co.*[2] and *United Housing Foundation, Inc. v. Forman*[3], established the three-pronged test for determination of whether an interest in a venture is a security within the context of the federal securities laws, i.e., an investment of money in a common enterprise with the expectation of profits to come solely from the efforts of others. Petitioners feebly attempt to negate the "investment contract" characterization of the limited partnership interests by the Court of Appeals below

[2] *S. E. C. v. Howey Co.*, 328 U.S. 293, 299, 66 S.Ct. 1100, 1103, 90 L.Ed. 1244 (1946).

[3] *United Housing Foundation, Inc. v. Forman*, 421 U.S. 837, 851-53, 95 S.Ct. 2051, 2060, 44 L.Ed.2d 621 (1975).

by absurdly contending in their Petition that the Investors (Respondents herein) did not look to or rely solely on CSI, the general partner of the Partnership and lessee of the cable television system, (i) to ensure that the fixed monthly rental under the lease would be paid to the Partnership (the Investors expecting to derive a profit thereby) and (ii) to expend the necessary efforts to cause the cable television system to appreciate in value. Exactly why this spurious and irrelevant argument is proferred by Petitioners is unclear, since it is not a question presented in their Petition for a Writ of Certiorari.

Petitioners also ignore their own characterization of the Investors' limited partnership interest. In their 1974 private placement memorandum, Petitioners stated that the limited partnership interests offered to the Investors were exempt from registration under the federal Securities Act of 1933. Why would Petitioners have made such a statement if the limited partnership interests offered to the Investors were not securities? Obviously, in 1974 Petitioners believed the interests were securities. Now Petitioners would have this Court metamorphose them (into what is not suggested by Petitioners) to escape the jurisdiction of the federal courts.

The cases cited by Petitioners to support their contention that there is a conflict among the Circuits concerning the applicability of the "sale-of-business" doctrine each involves a traditional form of security, i.e., ordinary capital stock of a corporation organized under state law. The Circuits which have endorsed this doctrine[4] have performed a ***Howey-Forman*** analysis to determine whether the facts warrant federal securities laws application, ignoring the conventional form (capital stock) of the instrument which evidences ownership of the venture purchased. The Circuits which have rejected this

[4] *Sutter v. Groen*, 687 F.2d 197 (7th Cir. 1982). *Chandler v. Kew, Inc.*, 691 F.2d 443 (10th Cir. 1977). *King v. Winkler*, 673 F.2d 342 (11th Cir. 1982).

doctrine[5] simply hold that a conventional form of security is a security for the purposes of the federal securities laws irrespective of what a *Howey-Forman* analysis would demonstrate. As the Court of Appeals below found the Investors' limited partnership interests to be an "investment contract" and not a "traditional" form of security, this case clearly does not fit within the category of cases where a conflict among the Circuits exists, albeit Petitioners misguided contentions to the contrary.

Each of the cases cited by Petitioners involved a purchase of capital stock where the purchaser alleged fraud in connection with his acquisition of the capital stock, except *Glick v. Campagna*. That case was brought by one of two shareholders against the other shareholder for fraud in connection with the sale of the former's stock to the latter. In the instant case, however, seven of eleven limited partner-investors complain of the egregious fraud of the general partner in connection with the sales of their limited partnership interests to one of the general partner's affiliates. The facts of this case are wholly dissimilar to the said cases cited by Petitioners in support of their Petition. Indeed, we have found no case (much less a conflict among the Circuits) involving sales by *investors* of their interests in a venture to the manager of that venture where a court did not find a "security" within the context of the federal securities laws. The Ninth Circuit recently held in a case similar to this one that a sale and leaseback arrangement was a "security," *United States v. Jones,* 712 F.2d 1316, 1321-22 (9th Cir.), *cert. denied,* —U.S.—, 104 S.Ct. 434, 78 L.Ed.2d 366 (1983)."

Petitioners conclude their argument by suggesting to the Court that Congress, in passing the federal securities laws, did

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[5] *Golden v. Garagalo*, 678 F.2d 1139 (2nd Cir. 1982) and *Vista Resources, Inc. v. The Seagrave Corp.*, 696 F.2d 227 (2nd Cir. 1982). *Glick v. Campagna*, 613 F.2d 31 (3rd Cir. 1979). *Coffin v. Polishing Machines, Inc.*, 596 F.2d 1202 (4th Cir. 1979) *cert. denied* 444 U.S. 868 (1979). *Daily v. Morgan*, 701 F.2d 496 (5th Cir. 1983).

not intend to prohibit securities fraud, no matter how egregious, where only a handful of investors are involved. Such a preposterous contention has long ago been rejected.[6]

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[6] Professor Louis Loss commentary on this point laid this proposition to rest long ago: "(i) *Non-limitation of Rule 10b-5 to the organized markets:* Does Rule 10b-5 apply to every transaction between any two persons when use is made of the mails or interstate facilities, or is its scope limited to transactions effected on the exchanges or in the more or less organized over-the-counter market? The argument for the narrower construction takes its cue partly from the reference in §10(b) to "the public interest," but primarily from the statement of the necessity for regulation in §2 of the act, which declares that "transactions in securities as commonly conducted upon securities exchanges and over the counter markets are effected with a national public interest which makes it necessary to provide for regulation and control of such transactions and of practices and matters related thereto, including transactions by officers, directors and principal security holders * * *" In any event, this statement of purposes does indicate a legislative concern with transactions of "insiders," apparently regardless of whether they are effected in the organized markets. But, beyond that, it should require compelling argument to restrict the literal language of §10(b). There is nothing in the section itself which limits its scope to the organized markets and such a restriction would be inconsistent with the care Congress took to make clear that §17(a) of the Securities Act applies without regard to the exemptions afforded from the registration provisions, including the exemption for non-public offerings. Moreover, there are positive indications both in the Exchange Act and in its legislative history that, unless the contrary appears in a particular section, the statute's scope extends to all transactions in securities." III L. Loss, *Securities Regulation*, 1466-67.

CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari should be denied.

Dated this 15th day of May, 1984.

Respectfully submitted,

CARL A. GENERES
13601 Preston Road
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(214) 233-0444

Attorney for Respondent

CERTIFICATE OF SERVICE

I hereby certify that three true and correct copies of the foregoing instrument were forwarded in the United States mail, postage prepaid, to Mr. Tom Thomas, Kolodey Thomas Dooley & Yeager, Eleventh Floor, Two Turtle Creek Village, Dallas, Texas 75219, this 15th day of May, 1984.

Carl A. Generes